

General Information Letter: General principles for determination of nexus are discussed.

September 13, 2000

Dear:

This is in response to your letter dated August 8, 2000 in which you state the following:

We have been advised to forward our request to your division. Please find enclosed, a copy of our letter dated April 17, 2000 to the Revenue Division. We await your reply as soon as possible.

Your letter of April 17, 2000 states as follows:

Our accounting firm has recently been engaged to perform the tax and accounting services for a New Jersey corporation engaged in the business of importing merchandise which is sold to various customers who use the material in their manufacturing process.

All sales are made and processed in New Jersey. Once a firm order is received, the sale is consummated. The merchandise is then shipped from a foreign country and received in public warehouses throughout the United States. One or more public warehouses are located within your state. The merchandise is stored for a period of up to thirteen (13) weeks in order to meet the customer's delivery requirements. The merchandise is then shipped to customers within the state in which the warehouse is located at which time title transfers to the customer. All shipments are made from the public warehouse via common carrier.

The warehouse facility is a public warehouse, available to other business entities. There is no common control/ownership between the warehouse and our client. Our client does not have any employees, salespersons, or other representatives at the warehouse, or any other location within your state.

Based on the facts and circumstances as detailed above, I would like your opinion as to whether or not the above activity creates an obligation on the part of our client to:

- a. Register to do business within your state as a foreign corporation
- b. Subject our client to any taxes by your state such as Corporation Business Tax, Corporation Income Tax, Personal Property Tax, Gross Receipts Tax, etc.
- c. File taxes using the apportionment factors as promulgated by "The Uniform Division of Income for Tax Purposes Act" (UDITPA).

In the event that your agency opines that our client does not have a filing responsibility, no further action will be required; however, should your agency opine that there is, in fact, a filing obligation, our client will want to be in full compliance. If our client voluntarily discloses their prior filing obligation, does your agency have a voluntary disclosure policy whereby penalties are abated, and prior filings are limited to three (3) years?

I trust that the above information sets forth the facts and circumstances that would allow your agency to provide an "informal-non-binding" opinion. Should any further information be required, please do not hesitate to contact the undersigned.

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill. Adm. Code §1200, or on the website <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. The following is our "informal-non-binding" opinion that you have requested.

With respect to your first question regarding whether or not your client should register to do business in Illinois, your letter indicates that your client sells merchandise to Illinois customers. As a result, they should register to do business in the state of Illinois. All inquiries regarding how to register as a foreign corporation should be directed to the Secretary of State at the following address:

Illinois Secretary of State
Department of Business Services
328 Howlett Building
Springfield, IL 62756
(217) 782-7880

Please note that registration with the Illinois Department of Revenue is also required for foreign businesses with Illinois customers. Enclosed please find a copy of Form NUC-1 along with its instructions. Form NUC-1 is used to register businesses with the Illinois Department of Revenue.

Your second question is more difficult to answer in that the basis of determining whether or not a foreign corporation is subject to Illinois taxes is whether or not the foreign corporation has "nexus" with Illinois. Unless protected by Public Law 86-272, a foreign corporation has the requisite nexus to subject it to Illinois income tax where any part of its income is allocable to Illinois in accordance with the provisions of Article 3 of the Illinois Income Tax Act (35 ILCS 5/301-304, 308). Public Law 86-272 is a federal statute that prohibits a state's taxation of interstate sales of tangible personal property.

Your letter indicates that you sell merchandise to Illinois customers. Assuming the merchandise is intangible personal property, your client corporation is not protected by Public Law 86-272, requiring payment of taxes on merchandise sold in Illinois.

Section 201 of the Illinois Income Tax Act ("IITA"), 35 ILCS 5/101 et seq, imposes a tax measured by net income on corporations for the privilege of earning or receiving income in this state. The Due Process and Commerce Clauses of the Federal Constitution limit the power of states to subject foreign corporations to tax. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction it seeks to tax (Quill Corp. v. North Dakota, 504 U.S. 298, 112 S.Ct. 1904 (1992)). Similarly, the Commerce Clause requires that the tax be applied to an activity with a substantial nexus with the taxing state. Id.

The fact that your client has merchandise sales in our area as well as hiring common carriers to transport their merchandise to the buyers' place of business may give rise to the requisite nexus to subject them to Illinois tax. For example, in the New York case of Orvis v. Tax Appeals Tribunal, 86 N.Y.2d 165, 654 N.E.2d 954 (1995), the court found that four visits to nineteen customers in one year was enough to allow the state to tax a Vermont wholesaler.

The question of nexus is highly fact-dependent. Therefore, the Department does not issue rulings regarding whether a taxpayer has nexus with the State. Such a determination can only be made in the context of an audit where a Department auditor has access to all relevant facts and circumstances. For that reason, we are referring your correspondence along with a copy of this letter to the Audit Technical Support Services Division.

In response to your third question, Illinois is moving away from the UDITPA apportionment factors. If a corporation does establish nexus with Illinois, business income will be apportioned to Illinois under Section 304 of the IITA. Illinois has used the 3-factor apportionment formula similar to the UDITPA that takes into consideration the (1) payroll, (2) property and (3) sales of a corporation. Beginning with taxable years ending December 31, 2000, only sales will be used. This change to a "single-sales factor" will be phased in over a two-year period. The single-sales factor approach looks at the amount of money that is retrieved from Illinois compared to the amount retrieved from all other states. As a result of our recent change to the single-sales factor approach, we no longer follow UDITPA.

Section 502(a) of the Illinois Income Tax Act ("IITA", 35 ILCS 5/502(a)) describes when an Illinois income tax return is required. For your convenience, enclosed please find a copy of the relevant portion of Section 502(a). Pursuant to Section 502(a), an Illinois income tax return is required in two situations. The first situation is when a taxpayer is liable for Illinois income tax. The second situation is, in the case of a corporation qualified to do business in Illinois, when the taxpayer is required to file a federal income tax return, regardless of whether such person is liable for Illinois income tax.

Your client will discover whether or not it is qualified to do business in Illinois after contacting the Business Services Department of the Illinois Secretary of State to register to do business in this state. If your client is qualified, then your client would be required to file an *Illinois* income tax return if it is required to file a *federal* income tax return. This is true regardless of whether or not your client has any sales in Illinois.

Your last question relates to our voluntary disclosure policy. Our voluntary disclosure policy comes from Section 3-10(c) of the Uniform Penalty and Interest Act (the "UPIA"; 35 ILCS 735/3-1 et seq.) which provides:

In the case of a failure to file a return required by law that is voluntarily disclosed to the Department, in accordance with regulations promulgated by the Department for receiving the voluntary disclosure, the tax may be assessed no more than 4 years after the original due date of each return required to have been filed.

Pursuant to this statute, the Department has promulgated its voluntary disclosure program regulation, 86 Admin.Code 210.126. For your convenience, enclosed please find a copy of the aforementioned regulation explaining the details of our voluntary disclosure rules.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of 2 Ill.Adm.Code §1200.110(b).

Sincerely,

Heidi S. Scott
Staff Attorney – Income Tax